

**STATE OF ILLINOIS**

**ILLINOIS COMMERCE COMMISSION**

<b>FairPoint Communications, Inc., C-R</b>	<b>:</b>	
<b>Telephone Company d/b/a FairPoint</b>	<b>:</b>	
<b>Communications / C-R Telephone</b>	<b>:</b>	
<b>Company, The El Paso Telephone</b>	<b>:</b>	
<b>Company d/b/a FairPoint</b>	<b>:</b>	
<b>Communications / The El Paso</b>	<b>:</b>	
<b>Telephone Company, and Odin</b>	<b>:</b>	
<b>Telephone Exchange, Inc. d/b/a</b>	<b>:</b>	
<b>FairPoint Communications / Odin</b>	<b>:</b>	<b>10-0125</b>
<b>Telephone Exchange, Inc.</b>	<b>:</b>	
	<b>:</b>	
<b>Joint Application for approval of the</b>	<b>:</b>	
<b>Reorganization of FairPoint</b>	<b>:</b>	
<b>Communications, Inc. pursuant to</b>	<b>:</b>	
<b>Sections 7-203 and 7-204 and for</b>	<b>:</b>	
<b>other relief.</b>	<b>:</b>	

**ORDER**

By the Commission:

**I. INTRODUCTION**

On February 19, 2010, FairPoint Communications, Inc. ("FairPoint"), C-R Telephone Company d/b/a FairPoint Communications / C-R Telephone Company ("C-R"), The El Paso Telephone Company d/b/a FairPoint Communications / The El Paso Telephone Company ("El Paso"), and Odin Telephone Exchange, Inc., d/b/a FairPoint Communications / Odin Telephone Exchange, Inc. ("Odin") (collectively, "Joint Applicants") filed with the Illinois Commerce Commission ("Commission") a verified Joint Application for approval of transactions and agreements that result in a change of ownership of more than 50% of the voting capital stock of FairPoint. The transaction involves a reorganization in bankruptcy of Joint Applicants that will result in a reduction of indebtedness of \$1.7 billion and the distribution of newly issued stock replacing FairPoint's current equity holders with certain debt holders. The Joint Application sought approval of the transactions as a transfer of control in accordance with Section 7-203 of the Public Utilities Act ("Act"), 220 ILCS 5/1-101 et seq., and a reorganization in accordance with Section 7-204 of the Act and for all other appropriate relief.

Pursuant to proper notice, this matter came on for hearing before a duly authorized Administrative Law Judge of the Commission at its offices in Springfield on March 17 and April 28, 2010. Counsel for Joint Applicants and counsel for Commission Staff ("Staff") each entered an appearance at the hearings. Ms. Lisa Hood of FairPoint,

testified in support of the Joint Application.<sup>1</sup> Samuel McClerren, an Engineering Analyst in the Engineering Department of the Telecommunications Division, Mike Ostrander, an Accountant in the Accounting Department of the Financial Analysis Division, Sheena Kight-Garlich, a Senior Financial Analyst in the Finance Department of the Financial Analysis Division of the Commission's Public Utilities Bureau, and Qin Liu, a Rate Analyst III in the Telecommunications Department in the Telecommunications Division, testified on behalf of Staff. With the continued existence of certain conditions imposed on Joint Applicants by the Commission in Docket No. 07-0191 and the imposition of three additional conditions described below, Staff recommended that the Commission find that the transactions met the requirements of the Act.

## **II. JOINT APPLICANTS' POSITION**

Ms. Hood testified that FairPoint is a corporation organized under the laws of the State of Delaware and is a publicly-traded company and that its stock is currently traded with Pink OTC Markets Inc. under the symbol FRCMQ. FairPoint, through its subsidiaries, provides a full range of telecommunications services, including local and long distance voice, data service, Internet, television and broadband services. FairPoint operates 33 local exchange companies in 18 states, with approximately 1.6 million access line equivalents.

Ms. Hood testified that FairPoint is the ultimate parent of C-R, El Paso, and Odin, each of which is an incumbent local exchange carrier providing service in Illinois subject to this Commission's jurisdiction and regulation. As of December 31, 2009, C-R, El Paso, and Odin provided service to 959; 1,825; and 3,681 access lines, respectively. Collectively, the three Illinois incumbent local exchange carriers provide service to approximately 6,465 access lines.

Ms. Hood testified that, in October of 2009, FairPoint filed for Chapter 11 bankruptcy protection to ensure the company's future by significantly strengthening its financial position, largely through a substantial reduction in its overall indebtedness. Pursuant to a Restructuring Plan, when FairPoint emerges from Chapter 11, it will do so with a capital structure that contains significantly less debt. In fact, more than \$1.7 billion, or roughly two-thirds, of FairPoint's existing debt will be converted into equity. As a result, FairPoint's financial position and ongoing liquidity will be substantially strengthened, thus positioning FairPoint as a healthy and viable company in the competitive telecommunications marketplace. Under the Restructuring Plan, more than 50% of the equity ownership of FairPoint will change.

According to Ms. Hood, since acquiring the Northern New England wireline telecommunication operations from Verizon Communications, Inc. in 2008, FairPoint has faced a number of challenges. Further, the recent turmoil in the financial markets, coupled with deteriorating financial performance, limited FairPoint's ability to attract potential investors or refinance debt. The significant general economic decline in the United States has reduced both consumer spending and business spending, and

---

<sup>1</sup> Ms. Hood adopted the pre-filed testimony of Alfred C. Giammarino.

contributed to an increased rate of decline in access lines and overdue accounts receivable balances from customers. All of these factors taken together, among others, have had a negative impact on FairPoint's overall financial performance and have caused the company to be unable to attain the performance projections made at the time it acquired the operations from Verizon. The inability to achieve the financial performance projected for the Northern New England operations at the time of the acquisition made it impossible for the company to service the approximately \$2.7 billion in debt obligations that it undertook in the acquisition.

Ms. Hood also testified that vigorous and growing competition in the communications and technology industries generally, and the competition that FairPoint has faced specifically, has contributed to the deteriorating financial results that FairPoint has experienced. For example, in most of FairPoint's service areas, it faces competition from wireless telephone technology, especially in the urban markets that the company serves in the Northern New England States. FairPoint also faces competition from new market entrants that offer close substitutes for the traditional telephone services that FairPoint offers, including cable television operators and competitive local exchange carriers that maintain their own facilities or lease services at wholesale rates. Cable companies, with their bundled offerings, also compete with FairPoint with respect to high-speed data and local and long distance voice services. Further, newer technologies such as VoIP also pose competitive challenges to FairPoint. Finally, Internet services -- comprised of online access services and online content services -- are highly competitive and are likely to become even more so in the future. As a result of the increasingly competitive marketplace in which FairPoint operates, FairPoint has experienced a decline in its customer base and decreasing revenue. Moreover, many of FairPoint's direct regional competitors, including other local cable and Internet providers, took advantage of both the lengthy approval period for the Verizon merger as well as the delayed Cutover and operating issues experienced as a consequence of Cutover by offering aggressive pricing on bundled packages of services and claiming to offer more reliable service.

Moreover, in October 2008, Lehman Commercial Paper, Inc. ("LCPI"), the administrative agent under a \$2.03 billion credit facility ("Credit Facility") the company had entered into, filed a petition for relief under Chapter 11 of the Bankruptcy Code. LCPI accounted for approximately thirty percent of the loan commitments under a \$200 million revolving credit agreement that was part of the Credit Facility. LCPI's undrawn loan commitments under the revolving credit agreement, totaling \$29.7 million, were terminated resulting in a permanent reduction in the funding available to FairPoint under its Credit Facility. Furthermore, due to the extreme uncertainty in the financial markets and the risk associated with LCPI, FairPoint accelerated its drawdown of the remaining \$100 million available under its \$200 million delayed draw loans, as well as \$100 million under its revolving credit facility. These draw-downs resulted in additional and unanticipated interest costs as these funds were not immediately needed for operating purposes.

In an effort to address its financial problems, FairPoint's management team worked diligently to expand and improve FairPoint's product offerings, diversify and

grow revenues, increase operational efficiency and operating cash flows and reduce debt obligations. Despite these actions, FairPoint's balance sheet remained highly leveraged, with substantial annual capital expenditure requirements and interest costs, and portions of the principal amount of the Credit Facility becoming due on a quarterly basis. This capital structure was not sustainable, particularly after taking into account the impact of (i) the recession in the United States and the associated high levels of unemployment, reduced disposable income and consumer spending, increased business failures and higher than normal uncollected receivables, (ii) the continued significant capital expenditure requirements for FairPoint to remain competitive in the telecommunications market and to satisfy conditions imposed by the regulatory orders approving the Merger and (iii) FairPoint's limited access to capital markets. As a result, FairPoint, with the assistance of its advisors, began to explore capital structure restructuring alternatives, including recapitalizations and a potential Chapter 11 filing.

Commencing in July 2009 and culminating in October 2009, FairPoint worked diligently, first with the holders of the Senior Notes and then with certain lenders under the Credit Facility, to obtain a sustainable solution to FairPoint's significant leverage. Through negotiations with a steering committee of lenders under the Credit Facility (the "Lender Steering Committee"), FairPoint reached an agreement in October 2009 with certain lenders (including the Lender Steering Committee), who held more than 50% of the indebtedness under the Credit Facility on a term sheet regarding the framework for a comprehensive balance sheet restructuring that would result in the conversion of more than \$1.7 billion of FairPoint's indebtedness into equity in FairPoint. Thereafter, FairPoint commenced the Chapter 11 Cases on October 26, 2009 the "Chapter 11 Bankruptcy").

The Chapter 11 case has been largely transparent from a customer perspective. FairPoint's customers have continued to receive the same products, services and customer service they received prior to initiation of the Chapter 11 case. Service has not been interrupted; service levels have continued to improve in many areas, and customer satisfaction has remained a top priority.

A Plan of Reorganization was filed with the Bankruptcy Court on February 8, 2010 and amended thereafter. FairPoint's First Amended Plan of Reorganization under Chapter 11 Bankruptcy with the related proposed Amended Disclosure Statement were each attached to the Joint Application in this docket (as Schedules 1 and 2, respectively). The overall objective of the Plan is to best balance the interests of all stakeholders, ensure that FairPoint can meet its obligations to its customers and fulfill their expectations, and to establish a financial structure that will insure FairPoint's financial viability and position the company for success in the future.

FairPoint states that the Plan will result in an appropriate capital structure for the company that will significantly strengthen its financial condition and liquidity by permitting it to shed a significant amount of debt. On the effective date of the Plan, FairPoint's debt will decrease by more than \$1.7 billion, or nearly two-thirds. As a result, FairPoint will be better positioned to improve the customer experience by making continued investments in its network, products and services, while requiring significantly

less cash to be directed toward servicing debt and paying interest. With the balance sheet restructured and its debt service costs reduced, the company will be able to focus its efforts on customers, employees and strategic growth plans, thus enabling it to maintain and improve its position as a leading provider of voice and data communications services.

Ms. Hood summarized the Plan of Reorganization as follows. She explained that the FairPoint Plan has the support of more than 50% of the lenders under our Prepetition Credit Agreement, FairPoint's two Northern New England labor unions, the International Brotherhood of Electrical Workers, or IBEW, and the Communications Workers of America, or CWA, as well as from key advocates for the States of New Hampshire, Vermont and Maine.

Under the Plan, and assuming that the class of FairPoint Unsecured Claims accepts the Plan, holders of Prepetition Credit Agreement Claims, which are identified as Class 4 in the Plan and which aggregate approximately \$2.1 billion, will be satisfied in full, as follows: (i) by a pro rata share of new term loans in the aggregate principal amount of \$1 billion, (ii) by a pro rata share of cash in an amount equal to all cash of FairPoint on the effective date in excess of \$40 million after taking into account all cash payments required to be made or reserved under the Plan on the effective date, and (iii) by a pro rata share of forty seven million, two hundred forty one thousand, four hundred thirty six (47,241,436) shares (90%) of the new common stock in the reorganized FairPoint (subject to dilution).

If, however, the class of FairPoint Unsecured Claims does not accept the Plan, then each holder of a Class 4 Prepetition Credit Agreement Claim will receive its pro rata share of fifty eight million, four hundred and eighty four thousand, five hundred eighty seven (58,484,587) shares (98.25%) of the new common stock (subject to dilution).

If they accept the Plan, holders of Class 7 Unsecured Claims, as defined in the Plan, representing approximately \$635 million, will be satisfied in full under the Plan, as follows: (i) by a pro rata share of four million, two hundred and three thousand, three hundred fifty two (4,203,352) shares of the new common stock in reorganized FairPoint (subject to dilution) and (ii) by a pro rata share of the new warrants to purchase seven million, one hundred sixty four thousand, eight hundred four (7,164,804) shares of the new common stock. However, if the holders of Class 7 Unsecured Claims do not accept the Plan, they will receive no distribution under the Plan.

In either the case of the class of FairPoint Unsecured Claims accepting or rejecting the Plan, a portion of the new common stock will be reserved for issuance pursuant to a Long Term Incentive Plan. Other than as set forth within the Amended Disclosure Statement within Section IV.C, details on the Long Term Incentive Plan will be provided at the time of the filing of the Plan Supplement.

Other claims, comprising those of Class 1 Other Priority Claims, Class 2 Secured Tax Claims, Class 3 Other Secured Claims, Class 5 Legacy Subsidiary Unsecured

Claims, Class 6 NNE Subsidiary Unsecured Claims, Class 8 Convenience Claims and Class 10 Subsidiary Equity Interests are unimpaired and will receive 100% recovery on their allowed claims, except for the Subsidiary Equity Interests (i.e. stock of subsidiaries held by parent companies), which will simply be reinstated.

The remaining claims and interests, which comprise those of the Class 9 Subordinated Securities Claims and Class 11 Equity Interests (FairPoint stock outstanding as of the bankruptcy filing) are fully impaired under the Plan and will receive no distributions at all. The prepetition FairPoint stock will be cancelled under the plan.

The reorganized FairPoint will have up to a nine person board of directors. Initially, up to seven of the new board members will be nominated by the Lender Steering Committee (with residents of Maine, New Hampshire and Vermont among the candidates). One of the new board members will be FairPoint Communications' chief executive officer and one of the new board members will be nominated by the steering committee of the Adhoc Committee of Senior Noteholders (in consultation with the Creditors' Committee and Adhoc Committee of Senior Noteholders) if the class of FairPoint Unsecured Claims votes to accept the Plan. If the class of FairPoint Unsecured Claims does not vote to accept the Plan, then the Lender Steering Committee will have the right to nominate up to eight new board members. (The members of the new board will be identified in the Plan Supplement, which will be filed with the Bankruptcy Court no later than five (5) business days before the deadline for voting on the Plan.)

FairPoint contends that the financial restructuring of FairPoint meets the statutory criteria of Section 7-204. The restructuring will have no adverse impact to the Joint Applicants in regard to the application of any of the statutory criteria contained in Section 7-204. While this would be the case if the Joint Applicants were not subject to the existing conditions agreed to in prior reorganization orders, the Joint Applicants are subject to those conditions. In this proceeding and in regard to the transaction, the Commission need only find, as it found in Docket Nos. 04-0299 and 07-0191, that the transaction with the present existing conditions meets the statutory criteria.

Ms. Hood testified that in Docket No. 07-0191 (and, before that, in Docket No. 04-0299), Staff proposed, the Joint Applicants accepted, and the Commission imposed a total of eight conditions in connection with the approval of the reorganizations. The eight conditions follows:

- (1) Staff should be granted access to all books, accounts, records, and personnel of FairPoint, C-R, El Paso, and Odin<sup>2</sup> and all of their utility and non-utility affiliated parent, sister, and subsidiary companies, as well as independent auditors' work papers;

---

<sup>2</sup> The Order in Docket No. 07-0191 related to four Illinois operating companies, the fourth being Yates City Telephone Company. By Order in Docket 99-0027, the Commission approved FairPoint's sale of the assets related to the Yates City exchange to Mid-Century Telephone Co-operative, Inc. Therefore, all references to the current FairPoint companies omit Yates City.

- (2) C-R, El Paso, and Odin should continue to comply with 83 Ill. Adm. Code 712;
- (3) FairPoint, C-R, El Paso, and Odin and all of their utility and non-utility affiliated parent, sister, and subsidiary companies should conduct annual internal audits to test compliance with Sections 7-204(b)(2) and 7-204(b)(3). The internal audit report documenting findings, conclusions, and recommendations should be submitted to the Manager of Accounting of the Commission by March 31<sup>st</sup> of each year and associated work papers should be available to Staff for review. The first internal audit report shall be submitted to the Manager of Accounting of the Commission on or before March 31, 2005;
- (4) That C-R, El Paso, and Odin be prohibited from increasing tariffed retail rates for one year after the effective date of the reorganization;
- (5) That C-R, El Paso, and Odin are prohibited from using any increased costs, as a result of this recapitalization, to justify any increases in their levels of support from the Universal Service Fund;
- (6) An Operating Company (i.e., C-R, El Paso, and Odin) will be prohibited from paying dividends to FairPoint or from otherwise transferring cash to FairPoint through loans, advances, investments, or other means that would divert their moneys, property, or other resources that is not essentially or directly connected with the provision of non-competitive telecommunications service if that operating company fails to meet or exceed the standard, set herein, for a majority of the service quality measures:

a) STANDARDS:

	C-R	El Paso	Odin
Toll & Assistance Answer Time (Part 730.510(a)(1)(A))	10 sec.	10 sec.	10 sec.
Information Answer Time (Part 730.510(a)(1)(B))	10 sec.	10 sec.	10 sec.
Business Office Answer Time (Part 730.510(b)(1))	60 sec.	60 sec.	60 sec.
Repair Office Answer Time (Part 730.535(a))	60 sec.	60 sec.	60 sec.
Interruptions of Service (Part 730.535(a))	1.0%	2.2%	3.2%
Installation Requests	1.0%	1.0%	1.3%

	C-R	El Paso	Odin
(Part 730.540(a))			
Trouble Reports per 100 lines (Part 730.545(a))	1.2	2.4	2.8

If any of the Operating Company's are granted a permanent waiver from having to comply with a key service quality measure in Docket Nos. 04-0278 through 04-0281, then that service quality measure shall not be included in the list. Until the Commission issues an order in Docket Nos. 04-0278 through 04-0281, key service quality measures Toll & Assistance Answer Time, Information Answer Time, Business Office Answer Time, and Repair Office Answer Time shall be included in the condition, but not used to determine compliance with this condition. If a permanent waiver is denied, then those service quality measures shall be used to determine compliance. A standard shall be the average of the two-year actual performance of that operating company for that service quality measure, for the past twenty-four months;

- b) **MEASUREMENTS:** Measurements shall commence on the date the securities are issued, and will be taken on an annual basis;
  - c) **ANNUAL REPORTS:** FairPoint shall file an annual report with the Chief Clerk's Office and posted in this docket. The annual report shall be filed December 1<sup>st</sup> of each year. Within the annual report, FairPoint shall identify each carrier and the title of the service quality measure, and by operating company FairPoint shall list the standard set by the Commission for each service quality measure and the actual performance for each annual period. The annual report shall present the actual performance data for every month after the date the securities are issued, with the initial month of data presented in the report being July 2004;
  - d) **FINAL NOTICE:** When FairPoint's issuer credit rating from both Standard & Poor's ("S&P") and Moody's Investors Service improves to investment grade, FairPoint shall send a certified notice to the Commission, with a third-party independent verification, that its issuer credit rating has been upgraded to investment grade. A corporate officer shall certify that the notice is true and accurate;
  - e) **DURATION OF CONDITION:** The duration of time this condition should remain in effect is until FairPoint's issuer credit rating increases to investment grade;
- (7) That FairPoint keep available exclusively for the Illinois operating telephone companies, under its senior secured credit facility, an amount



equal to the higher of \$1 million or the currently approved capital expenditures budget for all three Illinois operating telephone companies. FairPoint should certify annually to the Commission that the required amount is available to the Illinois operating companies for the ensuing year. Therefore, on December 1 of each year, FairPoint shall send a notice to the Commission certifying that such amount was then currently available, and for the ensuing year what the dollar commitment would be for the Illinois companies based on the capital expenditure budget for the following year; and

- (8) FairPoint's credit facility agreement shall provide that the ceiling on aggregate capital expenditures in any fiscal year for FairPoint and its subsidiaries shall be at least 30% of FairPoint's Earnings before Interest, Taxes, Depreciation, and Amortization ("EBITDA") for such fiscal year.

Ms. Hood testified that with the exception of condition (4) which had a one year duration that has now passed, making condition (4) no longer applicable, Joint Applicants remain subject to the remaining 7 conditions (Joint Applicants are proposing to reinstitute condition (4) as part of this Order.)

Ms. Hood testified that the proposed Chapter 11 reorganization will ensure the company's future by significantly strengthening FairPoint's financial position, largely through a substantial reduction in its overall indebtedness. Pursuant to FairPoint's Restructuring Plan, when FairPoint emerges from Chapter 11, it will do so with a capital structure that contains significantly less debt, in fact, more than \$1.7 billion, or roughly two-thirds, of its existing debt will be converted into equity. As a result, FairPoint's financial position and ongoing liquidity will be substantially strengthened, thus positioning FairPoint as a healthy and viable company in the competitive telecommunications marketplace.

According to Ms. Hood, the transactions will have no adverse impact in regard to the application of any of the statutory criteria contained in Section 7-204 of the Act to the Joint Applicants. The day-by-day management and operations of the three Illinois incumbent local exchange carriers will not be affected by the transactions. Ms. Hood indicated that even though there would be no adverse impact if Joint Applicants were not subject to any existing conditions, the Joint Applicants are in fact subject to certain conditions that were approved in Docket No. 07-0191 as set forth above. As a result, she asserted that the Commission need only find, as it found in Docket No. 07-0191, that the transaction with the present existing conditions meets the statutory criteria.

Pursuant to Section 7-204(b), the Commission must make seven findings before granting approval. Under subsection (b)(1), the Commission must find that the proposed reorganization will not diminish the utilities' ability to provide adequate, reliable, efficient, safe, and least-cost public utility service. In support of such a finding, Ms. Hood testified that the Chapter 11 reorganization will not directly affect any of the Illinois Operating Companies. To the extent the reorganization significantly strengthens FairPoint's capital structure and liquidity, it can only benefit those Operating Companies.

Ms. Hood also noted that the Joint Applicants are subject to conditions (6), (7), and (8) which Staff had recommended and the Commission imposed in Docket No. 07-0191 to assure compliance with the service quality requirements of Section 7-204(b)(1).

The second finding the Commission must make pursuant to subsection (b)(2) is that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customer. Pursuant to subsection (b)(3), the third and related finding the Commission must make is that costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission can identify those costs and facilities, which are properly included by the utility for rate making purposes. Ms. Hood testified that neither the Plan of Reorganization nor the change in ownership of the majority of the issued and outstanding common stock of FairPoint will have any effect on the three Illinois operating companies in regard to these two criteria. C-R Telephone, El Paso Telephone and Odin Telephone will continue to be subject to and will comply with 83 Illinois Administrative Code Part 712 and the cost allocation requirements contained therein. Ms. Hood also pointed out that in Docket No. 07-0191 Staff recommended conditions (1), (2), and (3) in order to further assure compliance with the requirements of Section 7-204(b)(2) and 7-204(b)(3). Those conditions remain in effect and can be relied upon by the Commission again in regard to compliance with those statutory requirements.

According to subsection (b)(4), the Commission must also find that the proposed reorganization will not significantly impair the utilities' ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure. Ms. Hood testified that the transactions and the proposed reorganization will not result in any change in the capital structure of C-R, El Paso, or Odin. The Chapter 11 restructuring and reorganization that have led to the filing of the Joint Application is for the express purpose of improving the ability of FairPoint to raise capital on reasonable terms and to maintain a reasonable capital structure. Significantly, the transaction has no direct impact on the Illinois operating subsidiaries and therefore will not "impair" them in any way. But the transaction's improvement of the parent entity through which the subsidiaries would raise any necessary capital, is ultimately a benefit to each subsidiary. In Docket No. 07-0191 Staff recommended conditions (6), (7), and (8) not only to support a finding that the transactions met the requirements of 7-204(b)(1) in regard to service quality but also to support a similar finding in regard to the requirements of Section 7-204(b)(4). Those conditions remain in place and provide further support for a finding that the reorganization meets the requirements of subsection (b)(4).

The fifth finding, pursuant to subsection (b)(5) that the Commission must make is that the utilities will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois public utilities. Ms. Hood testified on behalf of each of Joint Applicants that they specifically acknowledged that each of them will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois incumbent local exchange carriers.

The Commission must also find, pursuant to subsection (b)(6), that the proposed reorganization is not likely to have a significant adverse affect on competition in those markets over which the Commission has jurisdiction. Ms. Hood stated that the restructuring of FairPoint will have no impact on competition in the telecommunications markets for which the Commission has jurisdiction in the areas that are served by C-R Telephone, El Paso Telephone and Odin Telephone. The change of stock ownership in FairPoint at the time of the completion of the reorganization will have no impact on competition in those markets.

The final finding that the Commission must make is that the proposed reorganization is not likely to result in any adverse rate impacts on retail customers pursuant to subsection (b)(7). Ms. Hood testified that nothing in the proposed reorganization will result in any increase in the rates that C-R, El Paso, or Odin charge their retail customers.

Section 7-204(c) addresses any savings and costs related to the reorganization. With regard to this section, Ms. Hood testified that while FairPoint believes that there will be savings from the proposed restructuring, Joint Applicants do not project that C-R, El Paso, and/or Odin will achieve any savings at their regulated intrastate operations level as a result of the transactions. In addition, Joint Applicants also do not project that any incremental costs will be incurred at the Illinois operating company level in connection with the reorganization. Ms. Hood added that Joint Applicants specifically commit not to seek in this proceeding, or in any other proceeding before this Commission, to recover any costs that might be incurred in accomplishing the proposed transactions.

### **III. STAFF'S POSITION**

As described in greater detail in Staff's testimony, Staff has reviewed the record, including the Joint Application and testimony of Joint Applicant witness Hood, and, based upon the record, concludes that Joint Applicants' reorganization proposal satisfies the requirements set forth in Section 7-204 of the Act, subject to the conditions imposed on Joint Applicants in Docket No. 07-0191 that remain in effect as discussed herein and certain additional conditions proposed by Ms. Kight-Garlisch and discussed below. In general, Staff witnesses testified that the Commission must determine that Joint Applicants' proposal meets the requirements of Sections 7-203 and 7-204 of the Act in order to proceed with the reorganization plan.

Staff witness McClerren addressed the potential operational impacts of the proposed reorganization. Regarding Section 7-204(b)(1), Mr. McClerren explained that the Commission must find that, "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public service." Mr. McClerren explained that he has reviewed the service quality information for FairPoint's Illinois operations on the Commission's web site per 83 Ill. Adm. Code Part 730, as well as the annual filing requirements under Docket No. 07-0191. Based upon his review, Mr. McClerren noted that FairPoint's three Illinois operating companies have historically provided, and continue to provide, a very high level of service quality.

Relative to the seven standards in Condition (6) of Docket No. 07-0191, for the last four quarters, FairPoint has not approached failing any of the service quality benchmarks. FairPoint also continues to operate under Condition (6) from Docket No. 07-0191, and the management structure in Illinois is not changing due to this proposed reorganization. Mr. McClerren concluded that operationally, he found no evidence to support the conclusion that this proposed reorganization will diminish the ability of FairPoint's three Illinois operating companies to provide adequate, reliable, efficient, safe, and least-cost service.

Staff witness Ostrander testified regarding Joint Applicants' compliance via the proposed reorganization with Sections 7-204(b)(2) and 7-204(b)(3) of the Act. Mr. Ostrander explained that subsection (b)(2) requires that, before approving a proposed reorganization, the Commission find that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers and that subsection (b)(3) requires that, before approving a proposed reorganization, the Commission find that costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for rate making purposes. In addition to relying on Ms. Hood's assurances of compliance with the Act, Mr. Ostrander explained that the Commission can be assured that Joint Applicants will be in compliance with subsections (b)(2) and (b)(3) because Joint Applicants remain subject to certain conditions ordered by the Commission in Docket No. 07-0191. He observes that Joint Applicants have agreed in this docket to the following conditions as further evidence of compliance with subsections (b)(2) and (b)(3):

- (1) Commission Staff will be granted access to all books, accounts, records and personnel of FairPoint, C-R, El Paso, and Odin and all of their utility and non-utility affiliated sister and subsidiary companies, as well as independent auditor's working papers, to the extent permitted by the rules and policies of the independent auditor;
- (2) C-R, El Paso, and Odin will continue to comply with 83 Ill. Admin. Code 712; and
- (3) FairPoint, C-R, El Paso, and Odin and all their utility and non-utility affiliated sister and subsidiary companies will conduct annual internal audits to test compliance with Section 7-204(b)(2) and 7-204(b)(3). The internal audit report documenting findings, conclusions and recommendations will be submitted to the Manager of Accounting of the Commission by March 31<sup>st</sup> each year and associated working papers will be available to Commission Staff for review.

Mr. Ostrander suggested that the Commission order that Joint Applicants remain subject to the conditions as ordered in Docket No. 07-0191 as further evidence of compliance with subsections (b)(2) and (c)(3).

Staff witness Kight-Garlich reviewed the Joint Application to determine whether the reorganization proposal would comply with the requirements set forth in Section 7-204(b)(4) of the Act. Pursuant to subsection (b)(4), no authorization should be granted for the proposed reorganization of an Illinois public utility unless the Commission finds that “the proposed reorganization will not significantly impair the utility’s ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure.” Ms. Kight-Garlich testified that, subject to the conditions proposed by Joint Applicants and certain additional conditions, the proposed reorganization would not significantly impair FairPoint’s ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure.

Ms. Kight-Garlich noted that the Illinois Utilities have been able to satisfy all capital needs through cash generated from their operations. If, however, the Illinois Utilities were to require additional capital from external sources, FairPoint would be responsible for raising all additional capital. Given FairPoint’s bankruptcy filing, Ms. Kight-Garlich believes that accessing the capital markets on reasonable terms would be problematic. Therefore, Ms. Kight-Garlich concluded that FairPoint is unlikely to be in a position to raise necessary capital on reasonable terms on behalf of the Illinois Utilities.

Further, although the Illinois Utilities may generate sufficient funds to support their operations, Ms. Kight-Garlich states that the proposed reorganization offers no guarantee that FairPoint would not draw upon those funds to support its obligations to the detriment of the Illinois Utilities. Given the Illinois Utilities’ reliance on internally generated cash flows to meet its capital requirements and FairPoint’s poor financial condition, Ms. Kight-Garlich believes that excessive remittance of dividends by the Illinois Utilities is not an implausible scenario. Ms. Kight-Garlich states that if the Illinois Utilities were to remit dividends in excess of its “free cash flow,” their capital structures would weaken and could significantly impair their ability to raise replacement capital.

In order to address these concerns, Ms. Kight-Garlich observed that Joint Applicants would remain subject to the conditions imposed in Docket No. 07-0191 to protect the service quality and financial integrity of the utility subsidiaries. Included in those conditions are: (1) a restriction on dividend payments from the Illinois utilities to FairPoint if the Illinois utilities fail to meet certain service quality standards (until such time as FairPoint attains an investment grade credit rating); (2) a requirement that FairPoint keep available, under its senior secured credit facility, an amount equal to the higher of \$1 million or the current collective capital expenditures budgets for all three Illinois utilities for the Illinois utilities’ exclusive use; and (3) a requirement that the ceiling for capital expenditures set forth in FairPoint’s credit facility agreement be no lower than 30% of FairPoint’s annual EBITDA (Docket No. 07-0191 Conditions (6), (7), and (8), respectively). In Ms. Kight-Garlich’s opinion, these conditions ensure that the financial needs of FairPoint shall be subordinate to those of its Illinois utilities.

Ms. Kight-Garlich went on to propose three additional conditions<sup>3</sup> as follows:

- (9) The cost of capital, as reflected in the Illinois Utilities' rates, shall not be adversely affected by the reorganization of FairPoint. Subsequent to the completion of the reorganization, the cost of capital for the Illinois Utilities in any future earnings analysis or rate base/rate of return case shall be set commensurate with the risk of the Illinois Utilities exclusive of any reorganization effects. Joint Applicants will not oppose, in either a regulatory proceeding or an appeal of a decision by the Commission, the application of the principle that the determination of the cost of capital shall be based solely on the risk attendant to the regulated operations of the Illinois Utilities. Any declines in the Illinois Utilities' financial condition caused by the reorganization or its announcement shall be quantified by the Joint Applicants in any future earnings analysis, or rate base/rate of return case and adjusted as if such declines did not occur. Joint Applicants shall use an imputed or hypothetical capital structure in any future earnings analysis, or rate base/rate of return rate case, if necessary to reflect the cost of capital for the Illinois Utilities without the effects of the reorganization.
- (10) Joint Applicants shall not allow any affiliate of the Illinois Utilities, including FairPoint, to obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the Illinois Utilities' assets. The financial arrangements of all affiliates of the Illinois Utilities, including FairPoint, are subject to the following restrictions:
  - a. Any indebtedness incurred by an affiliate, including FairPoint, will be without recourse to the Illinois Utilities.
  - b. The Illinois Utilities shall not enter into any agreements under terms whereby the Illinois Utilities are obligated to commit funds in order to maintain the financial viability of an affiliate, including FairPoint.
  - c. The Illinois Utilities shall not make any investment in an affiliate, including FairPoint, under circumstances in which the Illinois Utilities would be liable for the debts and/or liabilities of an affiliate incurred as a result of acts or omissions of an affiliate, including FairPoint.
  - d. The Illinois Utilities shall not issue any security for the purpose of financing the acquisition, ownership, or operation of an affiliate, including FairPoint.

---

<sup>3</sup> This Order identifies these three additional conditions as (9), (10) and (11) to distinguish them from the first three conditions proposed by Joint Applicants and repeated by Mr. Ostrander.

- e. The Illinois Utilities shall not assume any obligation or liability as guarantor, endorser, surety or otherwise with respect to any security of an affiliate, including FairPoint.
  - f. The Illinois Utilities shall not pledge, mortgage or otherwise use as collateral any assets of any of the Illinois Utilities for the benefit of an affiliate, including FairPoint.
  - g. Joint Applicants shall assure that rates to the regulated service customers of the Illinois Utilities are not increased by reason of the effects of credit rating declines or other adverse consequences caused directly by the reorganization.
- (11) Dividend transfers from the Illinois Utilities to affiliated companies during any calendar year shall be reported to the Illinois Commerce Commission ("Commission") within one week of the declaration of dividends. "Dividend transfers" shall be defined as the amount of common dividends directly or indirectly remitted to affiliated companies. Within 1 week following the declaration of dividends by any of the Illinois Utilities as specified above, the Illinois Utility shall submit a report of the declaration of dividends to the Manager of the Finance Department and the Office of the Chief Clerk. The Illinois Utilities shall also submit financial statements for the last 12-month period available at the time of the dividend declaration report to the Commission's Manager of the Finance Department.

If FairPoint's senior debt is rated at least Baa2 by Moody's or its successors or BBB by Standard & Poor's or its successors, or if the Illinois Utilities are no longer owned or controlled by FairPoint, upon notification to the Office of the Chief Clerk and the Manager of the Finance Department, compliance with the dividend reporting requirement will not be necessary and the submission of financial statements may be suspended.

Consequently, she recommends that the Commission find that, with the continued imposition of Conditions (6), (7), and (8) from Docket No. 07-0191 and the imposition of conditions (9), (10), and (11) above, the proposed reorganization will not significantly impair FairPoint's Illinois utility subsidiaries' ability to raise necessary capital on reasonable terms or to maintain reasonable capital structures.

Staff witness Dr. Qin Liu reviewed rate and cost issues associated with the Joint Applicants' reorganization plan under Section 7-204 of the Act, specifically, subsections (b)(5), (b)(6), and (b)(7). Upon review of the Joint Applicants' filing, Dr. Liu concluded that the reorganization plan satisfies the requirements of the above-referenced provisions of the Act and, therefore, she had no objections to a Commission approval of the Joint Applicants' proposal. Subsection (b)(5), Dr. Liu explained, requires that, "the utility will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois public utilities."

Dr. Liu explained that subsection (b)(6) requires that, “the proposed reorganization is not likely to have a significant adverse effect on competition in the markets over which the Commission has jurisdiction.” Dr. Liu concluded that the proposed reorganization would not have an adverse effect on competition because it will not change the number of competitors in the local exchanges of the Illinois operating companies.

Subsection (b)(7), Dr. Liu continued, requires that, “the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.” Dr. Liu noted that Ms. Hood expressly stated that nothing in this reorganization will result in any increase in the rates that C-R, El Paso, or Odin charge its retail customers. Dr. Liu also relied on the reinstitution of Condition (5) that prohibited the Illinois companies from using any increase in costs as a result of this recapitalization to justify any increases in their level of support from the Universal Service Fund.

Mr. Ostrander also addressed Section 7-204(c). Subsection (c) requires that the Commission rule on (1) the allocation of any savings resulting from the proposed reorganization and (2) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated. Mr. Ostrander pointed out that Ms. Hood testified that there are no savings anticipated by Joint Applicants from its regulated intrastate operations as a result of the reorganization. Mr. Ostrander noted that Ms. Hood also testified that Joint Applicants are not seeking in this proceeding, nor will they seek in any other proceeding, to recover any costs incurred in accomplishing the proposed reorganization. Accordingly, Mr. Ostrander recommended that the order in this matter include the following:

- (1) The allocation of any savings resulting from the proposed reorganization will flow through to the costs associated with the regulated intrastate operations for consideration in setting rates by the Commission; and
- (2) Joint Applicants will not be allowed to recover any costs incurred in accomplishing the proposed reorganization in future rate proceedings.

#### **IV. JOINT APPLICANTS RESPONSE**

In rebuttal testimony filed by Joint Applicants, Ms. Hood acknowledged Staff’s reliance on all of the conditions and agreed to the imposition of the additional conditions (9), (10) and (11) proposed by Ms. Kight-Garlich.

#### **V. COMMISSION CONCLUSION**

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) C-R, El Paso, and Odin are each telecommunications carriers as defined in Section 13-202 of the Act, and each is providing telecommunications services as defined in Section 13-203 of the Act;



- (2) the Commission has jurisdiction over the parties hereto and the subject matter hereof;
- (3) the recitals of fact set forth in the prefatory portion of this Order are supported by the record and are hereby adopted as findings of fact;
- (4) for the reasons set forth by Joint Applicants and Staff, and in light of the conditions adopted in Docket No. 07-0191 that Joint Applicants remain subject to, and the additional conditions proposed by Staff to which Joint Applicants agree, all as set forth in the prefatory portion of this Order and enumerated in the attached Conditions Appendix, the proposed reorganization will not adversely affect C-R's, El Paso's, and/or Odin's ability to perform their duties under the Act, and the proposed reorganization meets the criteria set forth in Section 7-204(b) of the Act in that:
  - a) the proposed reorganization will not diminish C-R's, El Paso's, and/or Odin's ability to provide adequate, reliable, efficient, safe, and least-cost public utility service;
  - b) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by C-R, El Paso, and/or Odin or their respective customers;
  - c) costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities, which are properly included by the respective utilities for rate making purposes;
  - d) the proposed reorganization will not significantly impair C-R's, El Paso's, and/or Odin's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;
  - e) C-R, El Paso, and Odin will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois public utilities;
  - f) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets served by C-R, El Paso, and/or Odin over which the Commission has jurisdiction; and
  - g) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers of C-R, El Paso, and/or Odin;
- (5) the allocation of any savings resulting from the proposed reorganization should flow through to the cost associated with the regulated intrastate

operations of C-R, El Paso, and Odin for consideration in setting rates by the Commission;

- (6) Joint Applicants should not be allowed to recover any costs incurred in accomplishing the proposed reorganization in future rate proceedings in Illinois; and
- (7) the proposed reorganization and proposed transfer of control of FairPoint, C-R, El Paso, and Odin are reasonable, and the relief requested under Section 7-203 and Section 7-204 of the Act should be granted as set forth herein.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that consent and approval are granted to Joint Applicants to carry out all actions necessary to effectuate the transactions approved herein involving the reorganization and transfer of control of FairPoint Communications, Inc., C-R Telephone Company d/b/a FairPoint Communications / C-R Telephone Company, The El Paso Telephone Company d/b/a FairPoint Communications / The El Paso Telephone Company, and Odin Telephone Exchange, Inc. d/b/a FairPoint Communications / Odin Telephone Exchange, Inc.

IT IS FURTHER ORDERED that the consent and approval granted in this matter is subject to the conditions (1) through (11) described in the prefatory portion of this Order and enumerated in the Conditions Appendix.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this 25th day of May, 2010.

(SIGNED) MANUEL FLORES

Acting Chairman